

Conference Paper

Bancassurance and the Consumers' Perspective on Bank Service Quality

Deni Danial Kesa

Finance and Banking Programme, Vocational Program of Universitas Indonesia, Depok, Indonesia

Abstract

This article elaborates the perspective and quality of bank services between private and state-owned bank companies in Indonesia. The empirical result shows that consumers' perspectives on service quality remain constant and has big influence on the banks' performances. There are no changes for knowledge aspect from consumer. After product knowledge explanation to consumer, inconveniences of consumer reduce significantly for positive perspective. In addition, tools of marketing effect are documented, two factors have contributed to the process. Repeated information and language simplicity shows negative relation with consumer perspective. These results suggest that the bancassurance architectural structure for banks does offer some benefits and thus may become more prominent in future years.

Keywords: bancassurance, service quality, consumer perspectives

Corresponding Author:

Deni Danial Kesa

Denidanielkesa@gmail.com

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1. Introduction

As a result, for the need for the organised protection of human lives and property values, insurance had appeared very long time ago. From its origins, it was exposed to many changes, either of revolutionary or Ease of Use evolutionary nature, which led to significant milestones in the way insurance activities have been done. So as a result of the first major disaster of modern times, the great fire of London in 1666, the first insurance company was established. With the discovery of the law of large numbers the foundations of the modern insurance have been laid and after the great fire of the 1842 in Hamburg, where local insurance company Hamburg Fire Fund did not have enough capital to cover the damages, the first reinsurance company, Cologne Reinsurance Company, was established. In recent years, especially the last ten years, when the development of world economy and human society has reached a speed not recorded before in history, the changes that affect the insurance industry have become even more important. Including all the changes that occur in the insurance market,

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given their numbers and complexity, is challenging and never entirely feasible. With that in mind, only the identified most important changes and trends in the insurance market will be analysed. They are: integration processes, which encompass globalisation, consolidation and convergence, ever more frequent and intensified catastrophic events and the emergence of new risks, mainly caused by the emerging technologies.

2. Literature Review

2.1. Integration processes in insurance

Integration processes are ubiquitous in contemporary life and work, especially in economy sphere. Integration processes accomplished in order to achieve economic goals more efficiently have been present in the original association of individuals in families or tribes, and at the international level since the Roman Empire. Insurance is essentially based on the pooling of individuals who are exposed to the same type of risk, and the principles of reciprocity and solidarity. The development of insurance was encouraged by the development of international trade and was directly caused by the processes of connecting people in coastal areas of the Mediterranean. Following modern economic trends of economic integrations, the insurance sector is characterized by processes of globalisation, consolidation and convergence. All of them are essentially integration processes as in their essence are direct or indirect integrations in the insurance industry or insurance sector with other financial industries.

2.2. Globalisation processes

Processes of liberalisation and deregulation, are the most notable example of integration processes in the modern economy, including the insurance industry. These processes occur primarily in reinsurance, which is essentially an international business because it allows cross-border dispersion of risk. The need for the dispersion of risk has always been in the basic of the need for integration processes in the insurance industry. Insurance companies provide cross-border services by providing direct insurance in other countries from the home country or by establishing subsidiaries in other countries. The establishment of representative offices or acquisitions in other countries is much more common form of cross-border business of global insurers. In addition, globalisation of insurance and reinsurance is encouraged by the need to monitor foreign country operations of existing customers as well as the need for profit

enhancement, which achievement is limited in saturated home markets in developed countries. The connection between the globalisation of business and improvement of insurers’ business performance has been proven in numerous studies, for example, Capar and Kotabe (2003). However, globalisation has its limits in the form of expensive entry in some markets, business complication and the need of increased product customisation. Besides for global companies, the globalisation of insurance offers many advantages for markets in developing countries. These benefits include the development of new types of insurance, the application of best practices and experiences and the inflow of fresh capital. Certainly limits of the presence of major global insurance companies in regard to their local insurance companies, tow-away premiums and/or profits abroad and reduction of the total availability of capital and strategic economic and political influences must be taken into account. However, based on the more powerful positive impact, many countries are moving away from protectionist policies and state control toward more market access, that is they stimulate the arrival of foreign insurers. States seek to deregulate insurance so as to ensure a stable, properly managed and successful industry, carry out the privatisation of state-owned companies and open their markets to integrated with insurance. The increased presence of insurance companies tied with bank in Indonesia illustrates Table 1.

TABLE 1: Bancassurance in Indonesian banks.

No.	Type of banks	Dec 2012	Dec 2013	Dec 2014	March 2015	% change between 2016 and 2017
1	State-owned banks:					
	a. Government of Republic of Indonesia	5	5	4	4	-25.0
	b. Local (provincial) governments	26	26	26	26	0.0
2	Private domestic-owned banks	78	55	56	56	-39.33
3	Foreign-owned banks					
	a. Subsidiary (Joint Venture)	29	29	13	13	-123.1
	b. Branch office	10	11	10	10	0.0
4	Sharia banks	3	4	11	11	72.7
	Total	151	130	120	120	-25.8

Note: This table shows the number of banks based on different types of banks operating in Indonesia from December 2012 to March 2016 (various years).

Source: Indonesian Banking Statistics. Bank Indonesia

Most countries of the region there was a larger share of insurers, except for non-life insurance market in Indonesia, where the presence of foreign insurers was recorded higher in 2016 than in subsequent years. The majority capital participation in insurance companies in all banks has been noticed more in life insurance than in general insurance, with the exception of the insurance market in Private Bank.

The process of globalisation of insurance and reinsurance combined with ever tougher competition in the insurance market is causing an increasing enlargement of insurers [3]. Consolidation is the integration of insurers through mergers and acquisitions. The process of consolidation is driven by the desire to achieve greater market power, reduce operating and fixed costs and achieve economies of scale. Also, the causes of consolidation in the insurance sector may include the need to enter national markets of developing countries that are otherwise completely closed to foreign companies. The introduction of third generation of directives that make Solvency I framework for solvency regulation of insurers in the Indonesian banks has further encouraged the consolidation of activities. In the period from 2012 to 2016, around 114 mergers and acquisitions involving insurance to bank companies from have happened.

Regulatory changes, changes in accounting standards, changes in business practices and economic factors, such as economic growth, low interest rates, financial capital surplus, represents factors of consolidation in the insurance industry [4]. New regulatory frameworks in the U.S. (Sarbanes-Oxley) and the EU (Solvency II) will give further impetus to the consolidation in the insurance industry since it will give better treatment to bigger insurers. Consolidation allows the provision of adequate management skills for achievement of success in various types of insurance and improvement of market concentration and thus market power in existing markets. Of course, it is necessary to bear in mind that a higher concentration in the market caused by the decrease in bargaining power of clients, both individual and corporate insureds, essentially represents a socially unproductive trend. For that reason, there are regulations which aim to frame consolidation transactions with the aim of protecting public interest, and they include [4]: (1) capital requirements, (2) supervision institutions, and (3) maintaining market discipline. Also, the key problems for companies appear to be too high price that they pay in conducting acquisitions, false assumptions about the strategic compliance of transactions and inefficient process of consolidation itself [5].

Observed in the short term, further realisation of mergers and acquisitions transactions is almost certain, given that both life and non-life insurance and the reinsurance industry exhibit similar tendencies in terms of relatively low valuation of companies

TABLE 2: Demographic information.

Variable	Category	Percentage
Gender	Male	41.38%
	Female	58.62%
Age	Less than 22	1.12%
	23-27	4.00%
	28-33	0.25%
	Over 34	94.63%
Bank type	Public	25%
	Private	75%
Total (N)		240

Sources: Author data collection, 2016.

shares, compared with the period before the financial crisis, low premiums in the non-life insurance due to the absence of significant catastrophic losses, poor reputation of some companies and some high-capitalization companies. Life insurers can expect a similar trend given that organic growth in the previous year did not give significant results and that sales volume declined because of the crisis are not yet fully restored to levels before the crisis. In addition to insurance companies, financial needs of individuals and businesses have traditionally been fulfilled by banks, investment and pension funds and investment companies. In the late eighties and especially during the nineties, the concept of convergence has been created and developed. Convergence occurs at three levels, the level of supply of financial services, and the level of the services and at the level of financial advisory.

TABLE 3: Average age of respondents.

Banks Company	Mean (in years)	N	Std. Deviation
State-owned	39.62	8	7.836
Private	31.99	232	11.134
Total	35.9	240	9.691

Sources: Author Data Collection, 2016.

Historically the first form of cross-industry integration occurs at the level of supply or sale of insurance services and is realised on the basis of linking banks and insurance companies. These forms of integration are known as bancassurance. The highest level

of integration in the sphere of financial services deals is the formation of financial conglomerates, which typically combine provision of insurance and banking services and intermediation in financial markets.

Application of these forms of integrations is motivated by the reduction of costs of sales of insurance services, achieving inter-industry competitive advantages and opportunities to achieve additional returns. The negative aspects can be expressed in terms of financial contagion, the fact that was demonstrated by the global financial crisis.

The convergence of various services within the financial sector is historically the longest, with the exception of bancassurance, exercised at the level of consultation and advisory services within the services such as accountants, lawyers, and consultants for risk management, financial planners, insurance agents and the like. This convergence of perspectives has advantages in terms of securing economies of

scale and thereby costs reduction, especially considering the package of financial services to corporate clients. The disadvantage is the fact that advisors base their work on conditional fees and could deliberately give wrong advices to customers.

The trend of convergence of insurance and other financial services is also present at the product level. The emergence of alternative risk transfer mechanisms is primarily caused by limited capacity of insurance and reinsurance markets that are caused by increasing probability and intensity of adverse events [Njegomir, 2011]. In addition to adverse events for the development of alternative risk transfer insurance mechanisms the increase of capital requirements by rating agencies was especially important. On the other hand, the growing investor interest in investing in instruments linked to insurance risk is

noticeable. The increased interests by investors have appeared as these instruments provide relatively high yields that are uncorrelated with other instruments in the portfolio [6]. Also, the development of these forms of risk transfer is facilitated by the new solvency regulation [7]. Namely, by equal recognition and treatment of risk transfer mechanisms – reinsurance, hedging and securitization, requiring only proof of insurance companies on their real contribution to risk reduction, Solvency II will give insurers incentives to optimize assets and risk reduction incentive to the development of alternative risk transfer mechanisms, such as the securitisation. Application of alternative risk transfer mechanisms until now has showed no significant shortcomings except relatively high structuring costs and the existence of basis risk [8].

3. Discussion

3.1. Opportunity of bancassurance

Catastrophic damage was not characterized by simultaneous realisation of one or more catastrophic hazards. With the aim of providing a quantitative definition of the term catastrophic losses, Property Claims Services, an integral part of Insurance Services Office in the United States, catastrophic loss is any adverse event with an insured property value lost equal to or greater than \$ 25 million and that negatively affect a significant number of policyholders and insurers [Insurance Services Office, 2011].

Thanks to economic development, technical and technological progress, the development of medicine, the globalisation of business, increasing population and economic values, individuals, companies and society as a whole today are exposed to more risk than ever before. For example, the development of medicine has enabled a longer life span, but the longer life expectancy led to the creation of new risks and the need to cope with uncertainty regarding the provision of funds for old age. In a world characterized by a trend of increasing interdependence between countries and businesses, achievement of a catastrophic event, which is likely together with consequences constantly grows up, the existence of national borders is less and less recognisable, which clearly demonstrate the newly created phenomenon of global terrorism. Apart from the increased probability of adverse events, the other determinant that influence risk, the intensity of the consequences of adverse events, also increases. Concentration of people, buildings, factories and infrastructure per unit of land nowadays means that loss events with the same intensity could threaten more people and cause more damage to property than before [11]. For example, according to OECD estimates [12], repeating earthquake in Tokyo from 1923 would cause damage equal to approximately 75% of Japan's gross domestic product. Apart from the increased probability of adverse events, the other determinant that influence risk, the intensity of the consequences of adverse events, also increases. Concentration of people, buildings, factories and infrastructure per unit of land nowadays means that loss events with the same intensity could threaten more people and cause more damage to property than before [11]. For example, according to OECD estimates [12], repeating earthquake in Tokyo from 1923 would cause damage equal to approximately 75% of Japan's gross domestic product. Figure 1 illustrates the increased economic and impact of information to bancassurance in banking industry.

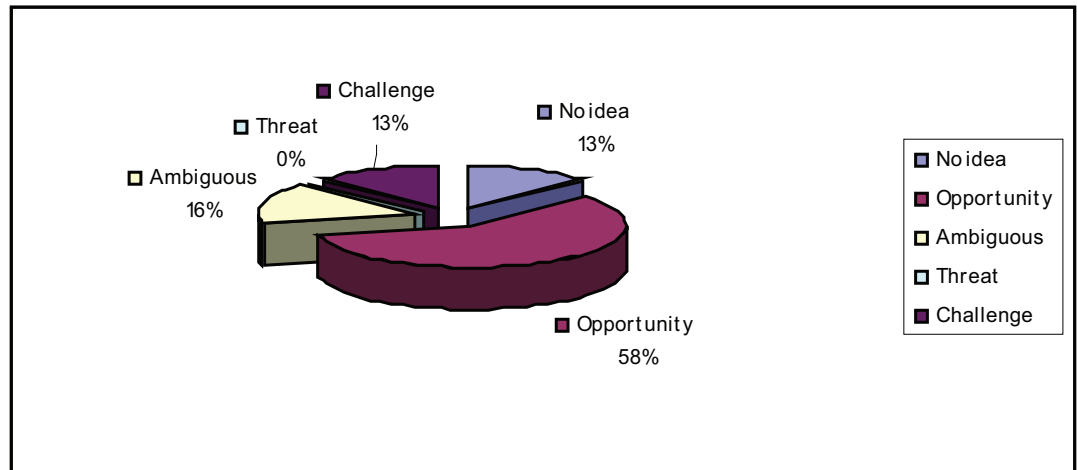


Figure 1: The perception of bancassurance opportunity. Source: Author data collection.

As can be seen from the graph, there is an increase trend in value of losses from the realisation of catastrophic events, especially at the beginning of the new millennium and during the nineties of the twentieth century. While insurance covered catastrophic losses in the period between the 1970 and 1989 cost insurance market on average \$8.3 billion dollars a year, during the period between the 1990 and 2007 they cost on average \$32 billion a year. Events such as hurricanes (especially the hurricane season of 2005 in the U.S. when catastrophe losses cost insurance industry more than \$90 billion, with most devastating Hurricane Katrina whose sole cost to the insurance industry was \$68.5 billion), floods (for example, in the UK floods in 2007 have caused unprecedented damage in 60 years), earthquakes (Northridge earthquake in 1994. year, an earthquake in Kobe, Japan in 1995. and the earthquake in Sichuan Province, China from 2008) tsunamis (e.g., tsunamis that hit Thailand in 2004 and Myanmar in 2008), terrorist attacks (e.g., an attack on the World Trade Center on 11 September 2001 cost insurance industry about \$ 22 billion, in 2007 dollars) and others, produce a growing adverse consequences for both the insurance industry and the global economy. Particularly strong impact catastrophic events have made to reinsurers. Figure 2 illustrates the negative impact that the realisation of catastrophic events had on the reinsurance market.

3.2. Risk implication on bancassurance

Specifically, insurers, even in conditions of high exposure to certain catastrophic risks, such as for example the risk of hurricanes in Florida, can achieve the minimisation of risks by allocating the available capacity on the risks that are not correlated with

each other, in this case that are not correlated with the risk of hurricanes in Florida. Unlike insurance companies that are directly informed about the risks in the portfolios, reinsurers obtain information indirectly, through insurers. That is the reason why reinsurers' ability to identify catastrophic risk exposures is reduced.

The realisation of ever more frequent catastrophic events with ever more intensive consequences led to problems of managing a large number of damage claims, but primarily to the problem of limited capacity of traditional reinsurance and retrocession market. One of the consequences of limited capacity and very high insurance premiums is the emergence of the previously described alternative risk transfer mechanisms that enable risk transfer to the capital markets. It also created new forms of cooperation between public and private sector, where the state instead of directly recovering the costs of adverse events seeks to encourage private initiative by forming insurance pools where only the highest levels of adverse events are borne by the state. The realisation of catastrophic losses is also present in Indonesia. However, the main problem in the region is a small insurance penetration and density and almost exclusive reliance on public funds in financing catastrophic consequences. With that in mind, the World Bank in 2006 initiated the development of an insurance pool for catastrophic risk coverage for private and state owned Bank in order to stimulate households and businesses to sign contracts of insurance against catastrophic risks. It is expected that the project will start with the start of the reinsurance facility called economy stimulus in January 2015.

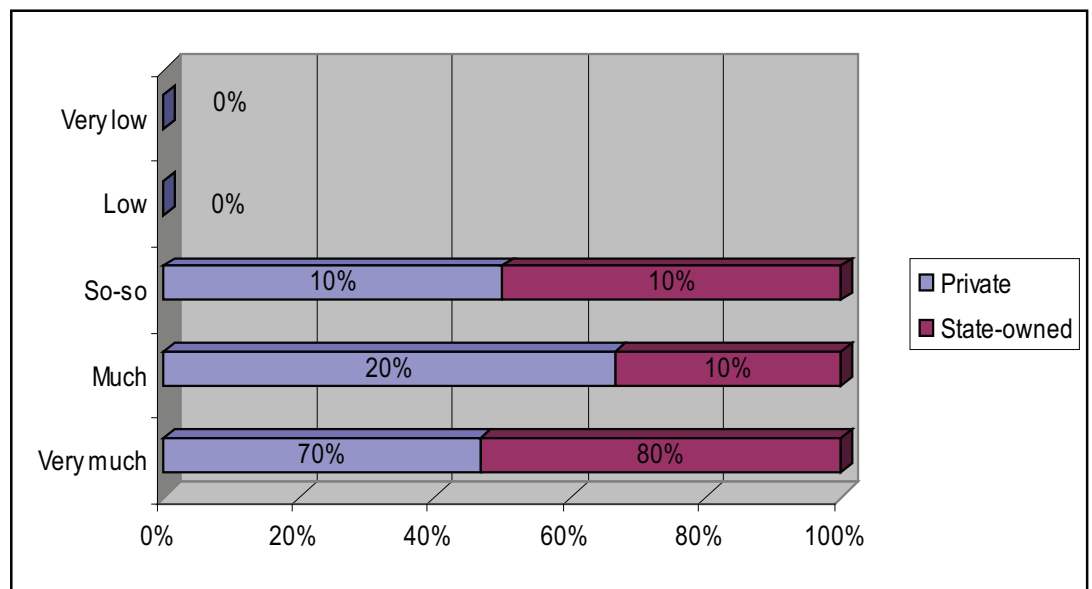


Figure 2: The importance of e-banking implementation. Source: Author data collection, 2016.

Insurance is a conservative business based on the application of mathematics and statistics and careful investment of collected premiums in order to comply with the obligations of both insureds and all others. However, insurance companies do not operate in isolation and the world around them is characterized by constant change. Constantly changing environment generates new risks. For example, the process of

globalisation has caused the emergence of risks that were previously assumed to be not significant or that does not exist. The realisation of the global financial crisis is one example of the manifestation of systemic risk, which likelihood is increased by globalisation. Also, the realisation of political risks in the countries of North Africa that were considered [AON, 2011] relatively stable, is an example of a sudden manifestation of risks with significant economic consequences. The importance of timely identification of the impact of new risks is evidenced by asbestos contamination. Although the risks of diseases caused by asbestos, primarily cancer, have not been anticipated in the seventies, they have realised. Over the past two decades, insurance companies have continuously been faced with new claims. Thus, asbestos have caused tens of billions of dollars costs to the insurance industry. A similar situation is possible with new technologies, especially nanotechnology, biotechnology and information technology. In the case of information technology, the greatest risk that has manifested so far has been the cyber risk. This risk did not exist before 1995. The cyber risk occurs and changes continuously with the development of the Internet and constant increase in the number of private and business Internet users. All individuals and companies that achieve presence on the Internet in any form are exposed to cyber risks. The best known examples of cyber risk exposures, with regard to the financial impact and media attention, are confidential information theft. According to the Federal Trade Commission's estimates these thefts adversely affects about 10 million people and cause unwanted costs of approximately \$50 billion a year. Also, there are many case studies that indicate that the risks associated with implementing information technology can affect many other types of insurance coverage. For example, a hacker attack on a computerized control system for irrigation in Australia caused flooding of parks and rivers and pollution of water [13]. Endangering public services by hackers' attacks could cause significant damage on the basis of various types of insurance policies. Insurance companies must take into account the above scenarios in risk management and rating. In addition to the risks and benefits of the direct use of information technologies they provide development opportunities for insurers. Insurance products related to information technologies, which are present in our region, are insurance coverage for computer hardware. However, the functioning of information systems interruptions caused

by software errors, viruses or other conditions are usually excluded. Recently, with the aim of exploiting opportunities for business development, insurance companies have begun to offer policies that cover risks associated with information technology. Although security conditions vary, this type of insurance can provide coverage for direct and for damage caused to third parties, coverage that was not existent before. Nanotechnologies are technologies that are based on the application of components whose size is measured in nanometers. A nanometer is a billionth of a meter, or the picturesque, the diameter of human hair is about 80,000 nanometers. Application of nanotechnology potentially offers unimagined possibilities in many areas such as data transfer speed, improved methods of treatment and prevention of various diseases, including currently incurable, the production of quality products at lower prices, reducing pollution, rational use of limited resources and so on. However, scientists point out that the application of nanotechnology could lead to the realisation of risk, although these are not currently possible to identify. Possible risks might lie in the domain of influence on human cells and biological processes, the possibility of their biodegradability and the elimination from land, water or air, the ownership of property of inventions related to nanotechnology, as well as in terms of the potential cataclysmic effects of these technologies in the case of self-reproduction. Careful testing and monitoring of negative manifestations of nanotechnology applications are necessary for the insurance industry in order to eliminate possibility of repetition of negative experiences in the past, as was the case with asbestos pollution.

An organization that represents biotechnology sector in the U.S. (BIO) defines biotechnology as the use of cellular and biomolecular processes in solving problems or making useful products. The simplest, biotechnology involves the use of living organisms in creation of useful products. Modern biotechnology offers many advantages by creation of new industries and products. Biotechnology has enabled developments in pharmacy, medicine, manufacturing of mechanical organs, agriculture and various other industries. In addition to creation of new opportunities, biotechnology has led to the creation of new risks, related primarily to legal, ethical and moral issues. These problems are particularly relevant to potential users of genetic information, such as employers, pension funds or insurance companies. An example of the complexity of the legal, ethical and moral aspects of application of biotechnology and especially genetic information is the issue of acceptability of the use of genetic information to refuse, limit or cancel insurance coverage. These aspects are expressed mostly in the form of fears that biotechnology and its application may cause unknown hazards to human health, environment, biodiversity and excessive political influence

of multinational corporations. In the very beginning of the industrial development of biotechnology or genetic engineering, for example, these risks were included within general liability insurance. With the increasing public debate, insurance companies excluded or limited insurance coverage for liability risk for these companies. Bearing in mind that liability insurance is particularly vulnerable type of insurance coverage, it can be expected that the supply of this type of insurance coverage in the future would be based on the principles by which insurance coverage for similar risks is now offered to pharmaceutical companies.

4. Conclusion

The insurance sector is inherently characterised by the integration processes. The globalisation of business, capital consolidation and convergence of insurance with other financial services offers many opportunities and dangers that insurance companies must be aware of when deciding to participate or not in the integration processes.

Increasingly, the realisation of ever more damaging catastrophic events is one of the most pronounced trends that characterise the modern insurance industry. This realisation of catastrophic losses undermines the foundations on which the insurance is based. By limiting insurance industry's capacity such trends leads to high insurance premiums that threaten vital economic and social role of insurance – the protection of policyholders. Given the trends demonstrated so far it is almost certain that these trends will affect the insurance business in the future. As a result, insurance companies must adapt by developing innovative solutions. The anticipation and adaptation is not only in their own interest but also in public interest. The emergence of new risks associated with information technologies, bio technologies and Nano technologies is evident. The ability to identify, measure and treat new risks will contribute to technological advances in the future. Technological advances will in turn create unimagined possibilities or improvement of human life and work and thus development opportunities for insurers. However, insurers must be aware of new risks that new technologies might carry with them and must be able to identify, assess and determine their own abilities for the acceptance or rejection of these risks.

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